EWA Mexican Supply Chain Webinar

Mexico is a good Supply Chain base for certain products
But not a replacement for China

"Should Mexico be part of your global Supply Chain strategy?"

March 30, 2021

east west associates®

DRIVING COMPANY GROWTH IN CHINA, ASIA, MEXICO & CEE

Webinar Agenda

Part 1:Brief Introduction of East West Associates

Part 2: "Should Mexico be part of your global Supply Chain strategy?"

Part 3: EWA focus on 5 industry sectors:

- Automotive
- Appliances
- Electronics
- Process Equipment
- Plastics

Part 4: Advantages / Disadvantages of sourcing from Mexican suppliers

Part 5: Case Studies

EWA Company Profile

- A leading provider of Corporate Strategy, Commercial, Operational & Risk Management solutions

- Founded in 2005, EWA executives have held senior management positions with P&L responsibilities for western MNCs, including

✓ Briggs & Stratton (NYSE: BGG)

✓ Bechtel Corporation

✓ Littelfuse, Inc. (NASDAQ: LFUS)

✓ Eastman Kodak (NYSE: KODK)

✓ Ashland, Inc. (NYSE: ASH)

✓ Barnhardt Manufacturing Company

✓ Hill & Associates

EWA Core Areas of Service

- Strategic Business Planning
- Manufacturing Footprint Optimization
- Supply Chain Optimization
- Performance Improvement
- HR & Executive Recruiting
- Risk Management
- M&A Due Diligence
- Business Assessment
- Research Services

World Map

Central Eastern Europe

United States

China

Mexico

South East Asia

- EWA has extensive global experience in numerous key industries:

Automotive	General Manufacturing	Durable Goods
Metal Fabrication	Consumer Goods	Filtration & Separation
Chemicals	Packaging	Electronics
Semiconductors	Food & Beverage	Medical Devices
Specialty Metals	Laboratory Equipment	Food Technology
Energy & Natural Gas	Industrial Textile & Apparel	Costings & Building Materials

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"Should Mexico be part of your global Supply Chain strategy?"

Manufacturers are evaluating their global supply chain footprint for multiple reasons, including:

1. Reducing their overall dependance on China, China duties & tariffs, increased freight costs/delays
2. Increasing their Mexican supply chain to service Mexican-based customers

Group 1: Many companies whose market is North America are looking to Mexican suppliers as replacements for their established manufacturers in China.

Group 2: Additionally, Mexico has increased their manufacturing capacity in a variety of industries, including automotive, electronics, medical, appliances and beauty products.

This increased domestic consumption in many cases will require companies to expand their supply chains in Mexico to service the domestic market.

Manufacturing in Mexico vs. China - The Cost Difference

20% lower employee wages costs in Mexico

20% lower industrial lease space costs in Mexico

70% lower transportation costs to the USA in Mexico

4% lower electricity costs in Mexico

60% lower natural gas costs in Mexico

Source: JP Morgan Chase

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Automotive Market Size – Mexico

- 1.3 million Vehicles produced 2019
- 42 brands 500 models
- 1,100 Tier 1 automobile manufacturing companies
- 2 billion USD FDI committed to Mexico
- All major global brands represented
- At $93 billion, cars or car parts were almost a quarter of all goods coming into the U.S. from Mexico in 2018.
- $22 billion worth of car engines, $5 billion in car seats, and $5 billion in chassis.
- Products such as electronics, connectors, fractional motors, after market accessories make up a large percentage of imports

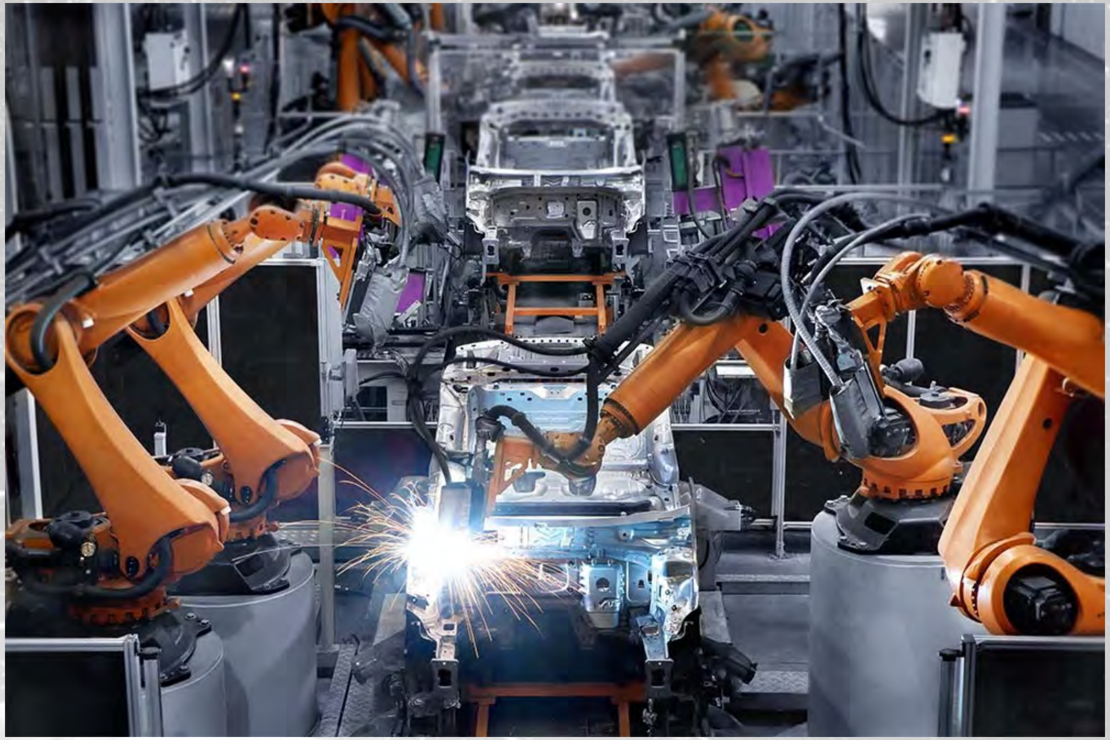
Mexican Automotive Industry Clusters

- Mexico has more than 400 parts-producing plants, according to U.S. government data.
- More than 2,000 companies make up the industry and 65 percent of those are foreign owned.
- In 2015, 60 percent of the $5 billion foreign direct investment in Mexico's automotive industry went into parts manufacturing, according to the U.S. government.

Availability of Raw Materials and Components

- With the ratification of the USMCA, the arrival of new auto parts suppliers is expected to fulfill the new rule of origin for the production of vehicles on North America, mainly manufacturers from China.

- The new origin rule increased from 62.5% to 75% of the content of auto spare parts from Canada, the U.S., or Mexico.



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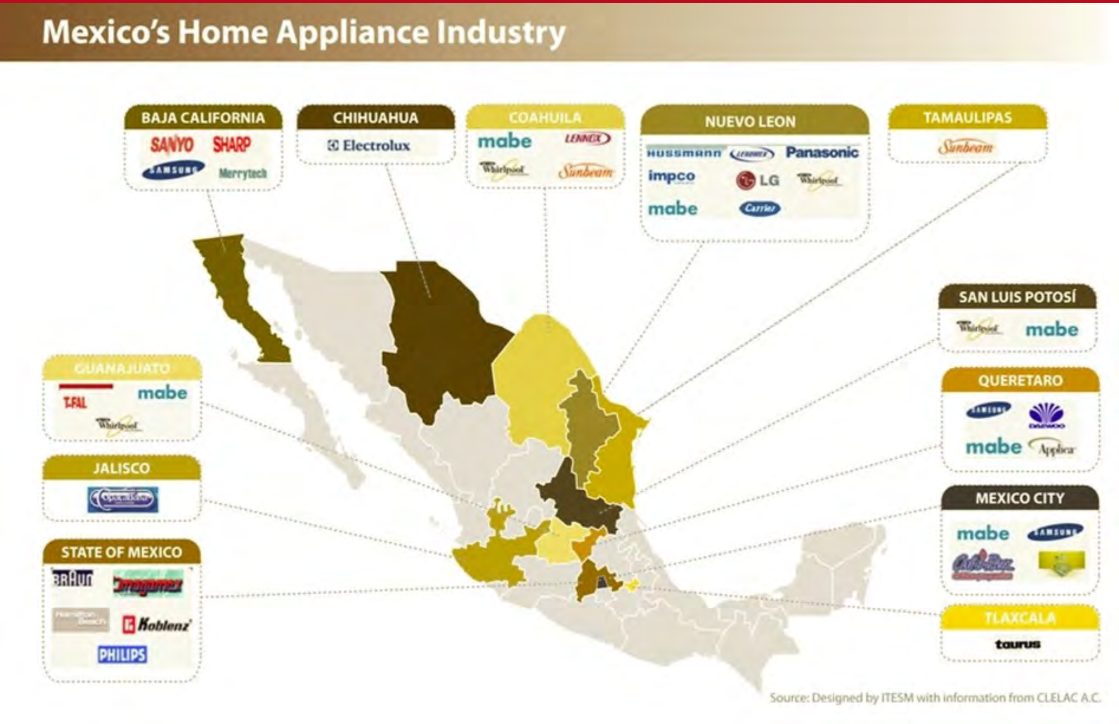
Small Appliances

- Mexico is the 2nd largest exporter of household and electrical appliances to the United States at $9B annually.
  - However, far behind China's $45B
- The sector also benefits from a large domestic market, growing at 4+ % annually
- Appliance manufacturing in Mexico benefits from the country's success in electronics manufacturing, as the industry is a major user of electronics/electrical components.
- New investment in the sector includes Chinese manufacturers (most recently Hisense)

Small Appliances



- Appliance-makers and their suppliers can be found throughout the country
- Nuevo Leon (Monterrey) has the highest concentration of the industry…with over 20% of the appliance workforce located in the area
- CLELAC – Cluster Association for Household Appliance Manufacturing – based in Monterrey
  - Manufacturers, Government, Academic members supporting the industry
- Saltillo, approx. 50 miles west of Monterrey, has seen an influx of Tier 1, 2, and 3 appliance manufacturing companies. Access to the US border is similar, and wages are typically 15-20% lower than Monterrey

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Electronics/Electrical Equipment

- Significant Industry with facilities throughout the country
- Exports $80B….80+% to USA
- Major Markets
  - Consumer Products – 30%
  - Automotive
  - Telecoms
  - Appliances
  - Medical
  - Power/Switchgear

Electronics/Electrical Equipment

- Diverse manufacturing base across the country
- Major International Brands Established
  - Increase in EMS, recently driven by Taiwanese investment
- SMEs supplying
  - Wire Harnesses
  - PCBs
  - Assembly Services
  - Repair Services

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Process Equipment

- Machinery and Equipment Manufacturing –
- Supplying Major Process Industries -
    - Food Processing
    - Chemical
    - Pharma
    - Mining

Process Equipment

- Advantages
  - Well Established Foundry/Metal Fab Sector
  - Technical Resources – Engineers and Workforce
  - IP Protection
  - Familiarity/Consistency with US Specs
- Disadvantages
  - Ability to work with exotic alloys limited
- Supplier Clusters
  - Monterrey-Saltillo

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Plastics Processing

- $20B industry with nearly 5,000 manufacturers
- Output split between consumer products and supply to downstream industries – Automotive, Aerospace, Electronics, Medical Devices, Packaging
- Resin Available from Domestic Manufacturers and Imports
  - International resin manufacturers have well established distribution networks
    - 80% of Resin consumed is imported
  - Major domestic sources
    - PVC, PET, HDPE

Plastics Processing

- Widespread availability throughout industrial states
- Injection molding capability available at many contract manufacturers/shelter companies in border regions
- Major cluster of injection molding equipment, plastics processing and technical resources in Queretaro area
  - Central location with good proximity to major auto manufacturers

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Advantages of sourcing from Mexican suppliers (as compared to China)

- Skilled Workforce
  - Low labor costs (recent studies show Mexico Labor at or below China)
  - Low Technical/Management costs (recent studies show equal to China)
    - Labor and Technical/Managerial costs are rising faster in China than in Mexico
- Lead Times
- Inventory
- Limited Disruptions in Supply Chain (Quality, Logistics)
- Open Trade Agreements versus Tariffs and trade disputes with China
- IMMEX/Maquiladora Program
- Communication (Time Zone within 3 hours)
- Protection of Intellectual Property

Disadvantages of sourcing from Mexican suppliers (as compared to China)

- China subsidizes manufacturing
- China offers “turnkey” solutions whereas Mexico typically requires more coordination
  - Mexico Shelters/Contract Manufacturers are much less likely to invest
- Scale of Chinese Infrastructure for raw materials and components
- Significant Logistics pipeline
- 20 year history of US companies sourcing, manufacturing and selling in China
- Availability of mid-level and executive managers

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Mexico Case Studies

Establishment of a Mexican operation with local supply chains

Development & Implementation of a supply chain in Mexico

Identification & Qualification of Mexican Suppliers

Corporate Strategy & Implementation: Consolidate North American manufacturing, close China plant & relocate operations to Mexico

Supply Chain Processes

1. Identification/Qualification of suppliers
2. Establishment of a Sourcing office
3. Covert & Overt Background Investigations of suppliers
4. Identification/Qualification of subcontractors and tollers
5. Make vs. Buy
6. Supply Chain Assessment
7. Supplier Performance Improvement

Manufacturing Processes

1. Global Manufacturing Footprint Assessment & Strategy Development
2. Contract manufacturing & Tolling
3. Outsourced Assembly
4. Site Selection
5. Implementation of Manufacturing

- ✓ Closure
- ✓ Relocation
- ✓ Construction
- ✓ Rationalization & Consolidation

Case Study #1

Establishment of a Mexican operation with local supply chains

Background

- A Michigan-based manufacturer of automotive components had been sourcing materials from China and assembling finished products in China for sale into Mexico & USA since the early 2000's. Due to escalating labor costs, growing compliance complexity, US-China trade tariffs and increased logistics costs, company profits had significantly decreased.

- As part of an initiative to decrease dependency upon China and increase operational profitability, EWA had suggested Mexico as an alternative location:

✓Get closer to Mexican based customers

✓Decrease their dependence on China

- EWA was engaged to develop a Mexican expansion strategic recommendation for their Board of Director's evaluation and potential implementation plan.

Step 1: Assessment of Client's Business

- Company had a leased assembly operation in China which had one year left on their 15 year lease
- Operation was well-run and had a good management team. Assembly operation costs were in-line with other assembly plants in the Nanjing area
- Suppliers were local Chinese vendors qualified by the manufacturer, whose performance had been good with on-time deliveries, limited product failures and execution of cost reductions measures on an annual basis.
- Supplier costs had increased in the prior 3 years and 25% tariffs were placed on the imported products to the US
- The long shipping times from China had resulted in delays for some US Customers

Step 2: Assessment of Mexico as a fit for the client

- EWA found available existing manufacturing space for either a full manufacturing plant or leased assembly operation
- Costs associated with the factory start up were in line with the EWA projected budget and less than the China industrial space
- The permitting process and government regulations to establish an operation were complicated but EWA had addressed them in prior manufacturing projects
- We evaluated a number of Mexican automotive suppliers and confirmed the availability & capacity – always an issue
- Imports of finished goods from Mexico into the US avoided the US/China tariffs
- Delivery to US customers would be improved

Step 3: Development of Expansion Strategy

- Based on our Assessment in Step 1 and Step 2, EWA recommended the establishment of a Mexican assembly operation supported by a local supply chain base.
- The costs associated with the assembly operation were more in line with the US manufacturer
- The company was not comfortable establishing a full manufacturing plant as their first investment in Mexico
- The assembly operation was recommended because we identified available sites for a leased operation with warehousing
- The local Mexican suppliers were available at similar pricing as the Chinese suppliers
- Establishment of an assembly operation would ensure US customers received their products much faster than delivery from China
- EWA submitted a detailed recommendation for a Mexican assembly operation with a projected budget to the corporate executives, who reviewed with their Board of Directors.
- Board approved the recommendation

Step 4: On the Ground Negotiation and Evaluation

- Negotiations with industrial park managers & property developers
- Site selection for assembly operation
- Finalization of site leasing agreement
- On-site audits/assessments and client visits of short-listed suppliers
- Arrange for client visits to suppliers
- Finalize selection following meetings with the suppliers

Step 5: Hands-On Implementation

EWA Project Manager coordinated with the US manufacturer the execution of this assembly operation, including:

- Development of budget & timetable for setup of the new operation
- Coordination of prototypes and qualification with selected suppliers
- Establish legal license for assembly operation
- Arranged for transport & setup of client's assembly equipment at the new site
- Assisted with commissioning & startup at the new site
- Assist in hiring and training of key local country personnel

Result

- Nearly all of the company’s spend on parts could be reallocated to Mexican suppliers at competitive costs.
- EWA identified and qualified multiple suppliers that could meet the technical, cost, and capacity requirements.
- Savings estimates for the first year of operation were:

Profit improvement of $2.5M annually from reduced logistics and tariff costs

Inventory reduction of $1.5 M

Delivery times reduced from 9 weeks to 3 weeks

- EWA completed the closure of the China operation

Case Study #2

Development & Implementation of a supply chain in Mexico

The Background

- An Pennsylvania-based supplier of upscale kitchenware was sourcing utensils and cookware from Guangdong, in southern China.
- The company had established an extensive supply chain in China. Nearly 80% of its product was sourced there, supported by engineers and quality assurance staff in China. The products were shipped to the US for warehousing and final shipment to customers.
- The introduction of tariffs added a $8MM cost to continuing to supply from China
- Decision was made to evaluate sourcing to Mexico to reduce cost, reduce inventories, and lessen dependence upon China.
- EWA was engaged to evaluate the company's global supply chain spend and determine which products could be sourced successfully from Mexico
- EWA Mexican executives were familiar with the industry and had existing relationships to move forward quickly

The Approach

Step 1: Assessment of Client's Business

- Extensive interviews with senior management and project technical team to gain understanding of
    - Overall company background and objectives for the project
    - Understand products, manufacturing processes and cost breakdown.
- Volume requirements, growth plans
- Develop a strong working relationship and communications

Step 2: Assessment of Mexico as a fit for the client

- Identify suitable regions to target based on
    - Established supplier base –casting, stamping, coating, enameling, wire bending, etc.
    - Security/Ease of access from US for client's engineers and QA staff
    - Logistics/Connectivity to US border
    - Availability of skilled labor, labor stability
- Identify potential partners/suppliers
    - Desktop research, EWA experience in the region, trade associations
- Selected Monterrey as focus area

Step 3: Development of Expansion Strategy

- Identified products to be sourced in Mexico
  - Focus on higher volume, to reduce complexity of transition
  - Target 20% of China spend as first step
- Define required supplier capabilities/scope of services
  - Stamping
  - Aluminum Casting
  - Powder Coating
  - Enameling
  - Plating
- Capability to provide
  - Warehousing/Stocking
  - Shipping and Customs Clearance
- Interviews to develop "short list" of suppliers
- Develop RFP for products and services

Step 4: On the Ground Negotiation and Evaluation

- Issue RFPs to short list of 12 suppliers
- Bidders required to provide extensive, detailed project proposals with:
  - Projected unit costs
  - Quality Control plans
  - Lead times/forecasting requirements
  - Warrantee/Failure Policies
- EWA audit of supplier's operations, focusing on
  - Material planning systems
  - Quality Management
  - Production equipment and Processes
  - Shop Floor management
  - Customer Service
  - EHS Compliance
  - Reputational Due Diligence
- Selected three suppliers to recommend

The Approach

Step 5: Hands-On Implementation

- Arranged visit to suppliers for Client approval
- Completed contract negotiations with suppliers
  - Initial unit manufacturing cost, payment terms, and projected productivity improvements
  - Productivity commitments/price breaks for increased volume
  - Inventory holding/stocking
- Facilitated establishing Project team to manage the transition

The Result

- **Successfully transitioned supply to Mexico**
  - Product quality acceptable based on 3-month evaluation process
  - Lead times improved….reduced 6 weeks transit time
  - Cost reduced $0.4M vs sourcing from USA, with potential for additional reductions as volume grows
  - Inventories reduced by 30% vs supply from China ($1.4M cash)
  - Response to demand changes improved
  - Reduced tariff impact

Case Study #3

Identification & Qualification of Mexican Suppliers

The Background

- An OH-based producer and distributors of valves, accessories, fittings, couplings, etc. had been sourcing from China for a number of years.
- The company had established an extensive supply chain in China. Nearly 80% of its product was sourced there, supported by engineers and quality assurance staff in China. The products were shipped to the US for warehousing and final shipment to customers.
- The company's cost to source from China had increased with the additions of tariffs, increased freight costs, longer lead times and stocked inventory.
- Board of Directors and senior management made the decision to evaluate sourcing stainless steel castings from Mexico to reduce cost, reduce inventories, and lessen dependence upon China.
- EWA was engaged to identify and qualify suppliers of stainless steel casting in Mexico.

The Approach

Step 1: Assessment of Client's Business

- Extensive interviews with senior management and project technical team to gain better understanding of the stainless steel products currently sourced from China
- Product specifications and product pricing
- Freight and logistics costs from the China suppliers – "landed costs"
- Volume requirements and growth plans

Step 2: Assessment of Mexico as a fit for the client

- Identified stainless steel casting manufacturers in Mexico
- Reviewed product specifications, volumes
- Obtained pricing from the manufacturers Ex-Works facility and delivered to the US
- Visited several stainless steel manufacturers

Result:

- EWA could not identify qualified Mexican suppliers for stainless steel castings which met our client’s price requirements
- EWA was able to identify and qualify Mexican suppliers of good castings which met the client’s specifications
- Castings do not have a high labor content, not a technically sophisticated product, Mexican prices 30% higher than China
- Traditionally, raw material steel and stainless steel are approximately 20% cheaper in China than North America
- EWA stopped the project

Case Study #4

Corporate Strategy & Implementation: Consolidate North American manufacturing, close China plant & relocate operations to Mexico

The Background

- MN-based manufacturer and distributor of electronic products had a Global Manufacturing & Supply Chain strategy centered on their 3 US operations and one China facility
- Primary customer base was US-based companies with both US and Mexican facilities
- US-based plants serviced their primary customer base in North America with low volume, specialized products
- China operation produced high volume electronic parts primarily for export to their North American customer base – company only supplied 20% of produced products to Chinese customers.
- The company had established an extensive supply chain in China. Nearly 80% of its product was sourced there, supported by engineers and quality assurance staff in China.
- The introduction of tariffs added a substantial cost to continuing to supply from China as well as increased freight rates, lead times, costs of carrying inventory, etc.

▪ In an effort to reduce costs, the board and senior management engaged EWA to evaluate the company's Manufacturing & Supply Chain Footprint and develop alternatives and business case which resulted:

✓ Consolidation of 3 North American plants into 1 operation

✓ Establish a Mexican assembly operation and supply chain to supply North America

✓ Close the China operation

Step 1: Assessment of Client's Business (Current State)

- Extensive interviews to understand the current global manufacturing and supply chain footprint and how it current work to meet their markets demands
- Analysis of the baseline information, including
  a. Assets: Factory buildings, Process Equipment, Manufacturing Processes
  b. People: Headcount by location, Organization Structures, Salary/Payroll, gaps in staffing/skillset?
  c. Raw Materials: Spend, Location of Key Suppliers
  d. Finished Products: Product Lines, Sales by Geography, Product Returns
  e. Inventories: Value, Locations
  f. Distribution Network: Warehouses, Distributors
  g. Operating Costs
  h. Logistics Costs
  i. Duties/Tariffs

Step 2: Conduct 3 Assessments:

- **Assessment to consolidate 3 US manufacturing sites**
- **Assessment to close the China manufacturing operation**
- **Assessment to establish a Mexican Assembly operation and local supply chain**

Assessment to consolidate 3 US manufacturing sites in MN

- Develop plan that includes key tasks, timetable, and estimated costs for the alternatives. This would typically include:

  a. People: new org structure, salary/comp implications of hiring additional staff
  b. Factory Requirements: Space needed, Utilities, Employee Amenities, Fire Protection, Equipment Installation, Office and Factory fit-out, opportunity to incorporate Lean improvements
  c. Startup cost estimate – additional costs incurred during transition to new site – on-boarding, training, inventory build, overlap of operations during startup period
  d. Operating cost estimate for the alternatives
  e. Logistics Costs estimate for new configuration
  f. Inventory estimate in the new configuration

Step 2: Conduct 3 Assessments:

- **Assessment to close the China manufacturing operation**
  a. Estimate Severance Costs, Retention Incentives of employees, positions, wages, years of service, age.
  b. Identify number of remaining employees post-closure and the requirements (if any) for additional office space. Estimate costs for rental and fit-out of office space, if required.
  c. Estimate costs for distribution centers/warehousing post-factory closure, if required.
  d. Regulatory Considerations: understand any governmental notifications, employee notification period, regulatory requirements for factory closure.
  e. Environmental Assessment: evaluate estimated cost of post-closure environmental survey/testing of factory site. Understand if waste, obsolete product stored on site could be a significant cost at closure.
  f. Inventory of Major Equipment: determine what will be salvaged, what will be scrapped. Understand potential equipment write-offs.
  g. Cost Estimate for Preparing Factory for Sale: estimated cost to remove equipment, pack/ship salvaged equipment to US, identify companies specializing in salvage and marketing of industrial property.
  h. Property Sale: estimate proceeds from sale of property.
  i. Service Providers: EWA can recommend local legal, accounting, real estate, HR partners as necessary

Step 2: Conduct 3 Assessments:

- **Assessment to establish a Mexican Assembly operation and local supply chain**

A. *Evaluate Mexico as a Manufacturing base – high level analysis to understand options, costs, timeline for moving manufacturing from China to a location in Mexico.*

   a. Alignment to establish project objectives and site requirements
      i. Determine which products, volumes to move from China to Mexico
      ii. Evaluate local supply chain providers to confirm availability of raw material supply in Mexico
      iii. Establish general factory requirements (Size, Utilities, Amenities, etc.)
      iv. Estimate headcount and organization structure
      v. Required timetable, capital constraints (drives decisions on lease vs. buy)
      vi. Regional analysis – identify best fit for operation looking at factors such as labor supply, logistics connectivity to serve eastern USA, ease of doing business, security, property cost, location of similar manufacturers, etc.
   b. Understand Costs and Timetable to establish operations in Mexico
      i. Lease vs Buy comparison for factory space
      ii. Factory fit-out
      iii. Operating Costs – Contract Manufacturing vs Shelter Model vs. establishing a legal entity
      iv. Comparison of logistics costs to supply USA and Canada from Mexico factory vs. import from China factory
      v. Model Inventory impact of move to Mexico

Step 3: Development of Expansion Strategy

Assessment to consolidate 3 US manufacturing sites

- Based on Assessment, EWA reviews with the client the Consolidation plan, including:

1. New organizational structure
2. Factory requirements
3. Start-up costs
4. Logistic costs
5. Employee severance
6. Operating costs at the remaining plant

- Client approved the consolidation

- EWA developed the Project Plan to implement the consolidation

Step 3: Development of Expansion Strategy

Assessment to close the China Operation

- Based on Assessment to close the China manufacturing plant, EWA reviewed with the client the costs, timeline, equipment write off, environmental and severance costs.
- <u>Client decided not to close the China factory because:</u>

✓ Environmental costs were too unpredictable

✓ China sales team felt the plant closure would reduce their China sales and signal the company was withdrawing from China

✓ Severance costs would be too significant

Assessment to establish a Mexican Assembly operation and local supply chain

- Based on Assessment, <u>company decided to not to move forward and establish a Mexican assembly operation</u>
- Rather, company decided to pursue contract manufacturing for specialty products

Step 4: On the Ground Negotiation and Evaluation

Consolidate 3 US manufacturing sites

- EWA Project Manager worked with senior company executives and department heads to implement the Project Plan and consolidate the 3 plants
- Supplier Consolidation
- Closure plans with employees at 2 facilities
- Expansion plans at remaining 3rd plant
- Equipment breakdown and installation at 3rd plant

Contract Manufacturing in Mexico for specialty products

- Issue RFPs to short list of 12 suppliers
- Bidders required to provide extensive, detailed project proposals
- EWA audit of supplier's operations
- Selected three suppliers to recommend

The Approach

Step 5: Hands-On Implementation for consolidation of 3 MN plants

- Expansion of the remaining MN plant
- Fit out of factory with equipment, personnel
- Completed contract negotiations with suppliers

Hands-On Implementation for Mexico expansion

- Arranged visit to suppliers for Client approval
- Completed contract negotiations with suppliers
  - Initial unit manufacturing cost, payment terms, and projected productivity improvements
  - Productivity commitments/price breaks for increased volume
  - Inventory holding/stocking
- Facilitated establishing Project team to manage the transition

The Result

Successfully transitioned to 1 primary MN facility

- Product quality acceptable based on 5-month evaluation process
- Operating cost savings of $600,000 annually
- Inventories reduced by 20% by shrinking the manufacturing footprint
- Simplified order fulfillment due to a single US supply point

Successfully qualified specialty Mexican electronics supplier

- Product quality acceptable based on 4-month evaluation process
- Lead times improved….reduced 6 weeks transit time
- Response to demand changes improved
- Reduced tariff impact

Contact Information

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